# Australian bank debt write-downs reveal deepening economic problems

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**4 August 2008**

Large write-downs announced in the past week by two of Australia's big four banks have underscored the worsening local implications of the financial meltdown that began in the United States last year. The announcements by the National Australia Bank (NAB) and the Australia New Zealand (ANZ) bank, accompanied by warnings that worse was still to come, sent share prices plummeting, wiping some $27 billion off the value of the major banks in just two days.

The markets were initially shaken on July 25, when NAB took investors by surprise by increasing its expected losses on US mortgage debt-related investments to more than $A1 billion. The bank lifted its write-off provisions by $830 million, on top of $181 million announced earlier in the week. As a result, NAB's share price dived 13 percent in a single day and is presently languishing at around $25, down from $44 last November.

NAB's chief executive John Stewart, who resigned this week, blamed the deteriorating US housing market, saying in a television interview: "I think we are not at the bottom yet." At a media briefing he commented: "Unfortunately, the behaviour of the housing market in the US leads us to believe that the worst-case scenario might not be too far away from the most likely scenario."

For months the NAB and other Australian banks have insisted publicly, and assured investors, that they had little exposure to the US sub-prime crisis, because their US mortgage-related investments were AAA-rated. Over time, it has become increasingly clear that these ratings were worthless, because "toxic" sub-prime debts were packaged with other debts and because the entire US housing market is now falling precipitously.

Given the banks' record of underestimating their losses, financial analysts expressed scepticism about the extent of NAB's disclosures, while the ratings agency Standard & Poor's issued a warning that it may have to lower the NAB's AA credit rating given it had only made write-downs on a small portion of its entire portfolio.

Even greater questions were raised about the banks' domestic debt situation on July 28, when ANZ lifted its possible charges to $1.2 billion for the second half of the year and slashed its full year profit forecast by a quarter, from $4 billion to $3 billion. ANZ's update sent its shares tumbling by 11 percent, the biggest one-day fall suffered by the bank since the 1987 stock market crash.

The announcement brought ANZ's possible write-downs for bad debts to more than $2 billion for 2008, with the bank admitting it had underestimated its problems in March, when it revealed possible losses of close to $1 billion. Significantly, ANZ's write-offs did not flow directly from the US, but from the emerging downturn in Australia and New Zealand.

ANZ chief Mike Smith declared: "We have no direct exposure to US sub-prime. We have no exposure to US sub-prime or mortgage related CDOs [collateralised debt obligations]. In fact our total exposure to CDOs is $5.5 million." Instead, he pointed to the "deterioration in global credit markets" and "the slowing of the global economy", which was "playing out in Australia and in New Zealand".

ANZ has been hit by the collapse or near-collapse of heavily-indebted Australian businesses such as Centro, which operates shopping malls, Tricom, a finance house, and Opes Prime, a stock brokage firm. The bank has also been affected substantially by the recession that has taken hold in New Zealand. Smith said arrears had only risen slightly in ANZ's Australian mortgage and personal debt portfolios, but warned it was unrealistic to assume that trend would be maintained in a slowing economy.

Smith warned that local homebuyers could again face more interest rate rises, regardless of any Reserve Bank decisions about the official lending rate. "We also have to expect further volatility and further stress in the international credit markets in terms of funding costs ... and we will have to continue to pass that on," he said.

Wider fallout is expected in the banking sector, with the other two big Australian banks, the Commonwealth and Westpac, now under pressure to raise their bad debt provisions. Banking analysts at UBS have estimated that the Commonwealth will push its write-downs close to $1 billion and Westpac to almost $900 million. In the *Financial Times*, the July 29 "Lex Column" bluntly stated that the NAB and ANZ announcements hinted at "broader carnage to come".

The Lex columnist cautioned against investing in Australian shares. "Australian bulls like to believe life is different Down

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Under: the commodity boom and full employment, the argument goes, offer a buffer against defaults. By extension, lending banks are sitting pretty once you erase the toxic made-in-the-US paper. But the Australian consumer does not look that robust. Household debt-to-income ratios, at 177 percent, are higher than in the US, according to Morgan Stanley. Houses are every bit as over-valued as elsewhere, if not more so: the average house/price ratio is 5.5 times."

The anxieties on the financial and share markets were heightened on July 28 when the International Monetary Fund (IMF) released its April Global Financial Stability report, stating that financial markets continued to be fragile and indicators of "systemic risks remain elevated''. It said easing the slump in US housing was necessary for financial markets to stabilise, but at the moment "a bottom for the housing market is not visible''.

In response to the IMF report, Australian treasurer Wayne Swan issued a statement in an attempt to allay fears in the banks' health. Although the IMF had highlighted the difficult global financial conditions, he insisted that Australia had a strong, well-regulated banking sector that was "well-placed to withstand the fallout''. Swan revealed that he and Prime Minister Kevin Rudd had held an urgent weekend meeting to discuss the situation with the Reserve Bank and the Australian Prudential Regulation Authority (APRA), which is meant to monitor the banks.

While Swan criticised the banks for making some "bad investment decisions," he defended the performance of APRA as a regulator and made clear that the government's only concern was to shore up public confidence in the banks. Of course, there was no suggestion of holding the banks and financial markets accountable for the burden being placed, by their activities, on the backs of ordinary people, who face historically unprecedented levels of household debt, higher interest rates, falling house prices and rising inflation.

Since the beginning of 2008, every month has seen fresh indicators that the financial crisis is having an increasingly serious impact on the living conditions of working people, and that broad sectors of the Australian economy are already in recession, despite the massive profits still being enjoyed by the big mining and energy companies.

Over the past week, reports have shown that consumer confidence slumped in July to the lowest level in 16 years, home-loan approvals fell in May by 7.2 percent—the biggest drop in eight years—followed by another 0.7 percent fall in June, and retail spending fell another 1 percent in June, accelerating a total drop of around 0.6 percent over the first five months of the year.

TD Securities senior strategist Joshua Williamson commented that retail sales were at "recession" levels. "It's higher interest rates from the major banks, higher costs of living, it's the credit squeeze ... it's the uncertainty in household wealth and falling share markets which are making people stay away from the shops."

House values have fallen to their lowest level since 2004, and Australian Property Monitors (APM) has predicted that the value of houses and units will fall by 10 percent across all mainland capital cities over the next year. APM general manager Michael McNamara said some borrowers would find themselves "sitting on negative equity" and "there is no doubt that the Australian market will see more foreclosures, repossessions and bankruptcies over the coming years".

If large numbers of people start losing their jobs, as now seems certain, many more working class families will be forced out of their homes. Up until now, the official unemployment rate has remained relatively low at just over 4 percent, but this masks the shifting of workers into insecure, casualised and part-time jobs. Moreover, major job losses have started to emerge, including some 1,500 layoffs by Qantas, 640 by Don Smallgoods and 600 by Starbucks.

More businesses are reconsidering their hiring plans because of the economic slowdown, according to the NAB's quarterly survey, which showed that business confidence for the June quarter fell four points to minus 8, the lowest level since the 1990-91 recession. Job losses are likely to intensify because bank lending to business has begun to dry up. Commercial lending rose by just 0.4 percent in June, a sharp fall from the 11.7 percent increase over the previous 12 months.

Retirement funds have recorded their worst losses since the Keating Labor government introduced compulsory superannuation payments in 1992. Because the funds have poured their contributors' money into the share, property and financial markets, their end-of-financial-year statements are revealing average losses of more than 6 percent.

According to SuperRatings, retail super funds will post an average loss of 9.8 percent, with industry funds down 5.7 percent. These results mean that all retirees will have less money to live on. There are already reports of people being forced to postpone their retirement.

Like Treasurer Swan, the Rudd government's minister for superannuation, Senator Nick Sherry was at pains to insist there was no need for panic, arguing that superannuation should be seen as a long-term investment. He admitted that many people, especially those close to retirement, would be shocked and angry. "There are probably millions of Australians who have never seen their fund statement show the end balance less than the opening balance," he said.

Another report by Rainmaker Research showed that financial advisers were paid $2.4 billion in fees and commissions in 2007 by super funds, even as the share market began to fall.

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